POVERTY OF NATIONS

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Prof. Menon and Friends,

I should like, first of all, to thank Prof. Menon not only for inviting me to speak to you but also for suggesting the subject, "Poverty of Nations". I cannot claim the wisdom of Adam Smith, the father of Political Economy, or of his book "The Wealth of Nations". But whatever the name—Wealth or Poverty—the subject-matter is the same. There is, perhaps, greater appropriateness in the title "Poverty of Nations" because today at least 1,500 million people are engaged in lifting themselves up from poverty.

The contrast today between the wealth of some nations and the poverty of others is striking. The per capita income in some of the more advanced industrial countries ranges between 1,000 dollars to 2,000 dollars per annum. The United States has a per capita income of nearly 2,000 dollars and other countries such as Canada, Switzerland, New Zealand, U.K., Australia, and Sweden, are not very far behind. Their per capita income exceeds $1,000. There are many others in the range of 500 dollars to 1,000 dollars; these are, by no means, in the top class, but certainly they are relatively prosperous, and their people not only have the elements of successful living but also have the factors to enable them to grow into a more prosperous and mature economy. But also down in the scale are a very

large number of countries with incomes less than 200 dollars, and some, mostly in Asia, whose people get even less than 100 dollars. India with a per capita income of less than 60 dollars occupies one of the lowest places, lower than even Ceylon and some other countries in Asia.

This contrast between the utter poverty of 1,500 million people and the rest of the world is really a matter of great concern. What is more, these differences not only persist, but the gap is getting wider each decade. The problem for these countries, therefore, is how to lift themselves up and reduce the differences. Let us look at the current situation. America, including the Latin countries, accounts for only 24% of the population of the world, but its share in the world income is about 60%. Europe has a population of about 21% of the world and a share of 25% in the world income. But Asia, excluding China,—Chinese statistics are defective—accounts for 50% of the population, but only 11% of the world income. This indicates how desperately poor the large majority of Asian countries are.

What are the causes of these differences? Why are some nations relatively prosperous, and others poor? One explanation is the differences in the material and natural resources and consequently in income and wealth. But this does not appear to me a complete explanation, for there are countries, such as Japan, relatively poor in natural gifts, but which have worked themselves up to become rich, whereas in India, and more particularly in Indonesia, resources are large, but the level of development and the per capita income are low.

Some ascribe this poverty to the large population and others emphasise the rate of growth of population suggesting that when the rate exceeds 1% or 1.5%, poverty sets in. Neither of these arguments, again, appears acceptable. For, New Zealand and Switzerland with a relatively small population are economically advanced and there are countries such as U.S.A. with a relatively large population but also rich. To hold, therefore, that the size of the population is the major determinant of wealth or poverty appears questionable. Nor is the rate of population growth so very

significant. For, some countries, *e.g.* U.K., during the most spectacular period of economic expansion in the 19th century had a rate of population growth far higher than that of India today. Similarly, in U.S.A in the post-war period population has increased annually by 1.5% to 2% and yet American prosperity has not slowed down. While, therefore, population may have an influence on poverty, it is not as significant as claimed; so also the association of the temperate zone with wealth and the torrid zone with poverty. Nor is there much in looking to the racial explanation of prosperity.

Sometimes domination by other countries as in the case of British colonies has been suggested to explain depressing economic level. While there may be an element of truth in this, instances might be cited,—for example, Nepal and Afghanistan—, where political independence has not improved national conditions.

The real explanation for poverty and riches is probably something different, and before we seek it, I shall refer to the common features of the poorer peoples. Today, excepting Japan and probably China and Malaya, which are now in the take-off stage in economic growth, all countries in Asia are definitely poor. They have certain broad characteristics. First is the fact that a very large percentage of the population is employed in agricultural production. Seventy to eighty per cent are engaged in this way as compared with about ten per cent of the people employed in agriculture in many of the advanced industrialised countries. This means that, in the latter, a tenth of the population is enough to supply the food and agricultural raw material needed by the whole country, whereas in India, for instance, as many as eight out of every ten are required to meet this basic need of the community. A second feature is the high population pressure as measured by the area of land available per capita. This "man-land ratio" is in the poorer countries very low and has led to under-employment and unemployment in the rural sector. Yet another common characteristic is the low level of technical skill both in agriculture and in the non-agricultural sectors. This results,

on the one hand, in low productivity and, in the other, in a low savings margin, which often is negative.

The predominance of agriculture of a low order of productivity has compelled these countries to depend for their foreign exchange resources on the export of a few major commodities—sometimes, even of one only. Thus, Burma's economy is largely oriented to the export of rice, that of Indonesia, to rubber and oil, and of Pakistan, to cotton and jute; Malaya depends on tin and oil exports and Ceylon on rubber and tea. This feature of economic dependence often subjects the countries to very severe fluctuations in their annual incomes. As a matter of fact, during the last decade, the incomes have sometimes declined by as much as thirty per cent in a single year.

II

These common features in the poorer countries necessarily suggest the existence of common explanations. From Adam Smith to this day economists have been attempting to explain these features, and the general problem of growth: why some countries grow from wealth to larger wealth, while others stagnate. Adam Smith explained in terms of institutional factors. That is, if the proper institutions—legal, political and social—are formed in the country, progress automatically follows, because the natural tendency of the people is to work, save and invest, and this process leads to prosperity. The institutional approach appears to me to offer only partial explanation.

About three decades after Adam Smith, the economist, Malthus, explained poverty in terms of over-population, by stating that an increase in food supply leads to an increase in population, and that this results in population outstripping food supply, thereby increasing poverty and misery.

Apart from such stray attempts, nineteenth century economists paid little attention to the co-existence of poor and rich countries. In fact, not till the Great Depression of the 1930s, when economic growth even in the prosperous countries received a setback, did economists, as a class, turn

their attention to this problem. Political resurgence in the Asian countries in the post-War years has given a new importance to the problem of growth. As the more developed among the underdeveloped countries, India can probably explain the causes better than others.

One of the main reasons why some societies have remained poor appears to be their being wedded to tradition and, thus, to stagnation. They have insulated themselves against technological changes by remaining hierarchical and feudal with marked class differences, geographical and occupational immobility of population and an indifference to raising their standards of living by hard work and sustained effort. The dominance of age-old values has made their attitudes to population growth, incomes and savings deep-rooted and inflexible. In such a society, the underlying philosophy is the search for poverty and not for wealth. It is difficult for a society to grow if the people decline to take advantage of technological advances.

But more importantly, the contrast between the old society and the modern one lies in the manner of utilising the surplus, *i.e.*, not conducive to economic growth. Look at the way in which feudal societies were spending their incomes—in ceremonies, in ostentation, in jewellery, and so on—and hardly anything for capital formation. The basic difference between a progressive society and a stagnant one lies not in whether there is any surplus but on how the available surplus is utilised—whether in productive manner or not. This, I think, is the crucial determinant. If a society is determined to direct the surplus into productive channels, the basic condition of progress is present; otherwise, it does not exist.

There are also certain other pre-conditions of development. To start with, a reasonable degree of political and economic stability is necessary. There are in Asia today several countries where political conditions are not normal and so the economy is not stable. Political stability is necessary for economic security, and so is a proper legal framework to assure the entrepreneur the enjoyment of his reward. If these pre-conditions are lacking, much progress cannot be

expected. If these conditions are given, poor countries can certainly expect higher rates of development.

Several advanced countries too started in a very poor way, as we have done, but at some stage or other reached, what may be called, the take-off point. Although this point differs in different societies and economies, it is really the stage where further progress becomes almost automatic, and its economy becomes more and more self-sustaining. Different countries have reached the take-off stage at different periods in their history. Great Britain, for instance, reached it between 1783 and 1850 during the time of the Industrial Revolution, and France was a little later in the field—1830-1860. Germany reached its take-off point between 1850 and 1870, U.S.A. between 1860 and 1900, Sweden between 1868 and 1890, Japan between 1878 and 1910, and Soviet Union 1920-1927.

Although further stages are necessary before the economy becomes mature, the take-off point is the crucial initial step. China today has almost reached this point, and India is passing through a very critical and crucial stage and we may reasonably expect that if the Third Plan is properly formulated and implemented our take-off stage may be from 1961-65.

III

What, then, are the factors that lead to the mature stage? How can a country reach a stage where it can increase its national income by 3% to 5% per annum, in order that the per capita income might grow proportionately? If this is to be possible, the determining factor is the rate of capital formation, *i.e.*, the amount of savings diverted into production. The investment necessary for a reasonable growth should provide not only for the normal rate of expansion but also for the increase in population. If population increases rapidly, as in Ceylon (3% per annum), or even as in India (1.6% according to the Second Plan and 2% according to more recent estimates), the surplus available for further investment is reduced. This, more than anything else, is the real cause of disquiet in some countries.

What then is the key to self-sustaining growth and how can a country raise its rate of saving by at least 2-3% per annum? Economists have worked out partly on the basis of historical analysis and partly by theoretical reasoning the investment required in order to raise an additional amount of income. Supposing the national income is to grow by Rs. 100, the additional investment required has been estimated at Rs. 300-400. This is the capital-output ratio, and the actual ratio—3 : 1 or 4 : 1 and so on—depends upon the nature of the economy. In India it is 3 : 1; that is to say, you will have to invest Rs. 300 in order to get an additional income of Rs. 100. To have a per capita growth in income of 2% per annum while the population is increasing at 2% at the same time, investment—current and additional—will have to be at least 12-15% of the national income just to maintain this rate of growth. The development from the traditional stage of economy to the take-off point depends on whether the people are able and willing to save sufficiently. Historically several countries, Japan and U.S.S.R. for example, have invested as much as 20%. But, generally speaking, there is not a single country which has reached this stage of growth with net investment of less than 12% of its national income. The trouble with Asian countries is that they are not able to find savings of this order.

The Third Plan is likely to be of the magnitude of Rs. 10,000 crores, *i.e.*, Rs. 2,000 crores of investment per annum. This volume of saving for a country whose national output is Rs. 12,000-13,000 crores is really not much. With this national output as given, the target of Rs. 10,000 crores is the minimum if a growth of at least 2% per capita per annum is to be assured. Two real problems confront us at this stage. One is : How can a country which is now saving 6-8% double its savings rate? The answer is that this can be done through taxation, public borrowings, the profits of public enterprises, and voluntary savings such as provident fund, insurance, and so on. It can also come through the profits of private business. It really does not matter how these savings are effected, so long as they are of the order of 12% to 15% to facilitate the transition to the take-off stage.

This savings rate technically termed the "Savings Coefficient" should for a country like India be of the order of 12 to 15 per cent. If we are not able to find domestic resources of this magnitude, then it will have to be supplemented by foreign resources such as loans, aid, and grants. But, I think that it should be possible to find all or most of the funds internally. For, assuming that our national income in 1960 will be Rs. 13,500 crores, the amount required for maintaining the present level of consumption, for Governmental expenditure and for maintaining the economy at the current level of activity will have to be deducted. The balance should be available for investment. Although theoretically we can mobilise 15 per cent for investment, in practice, there are difficulties. For instance, agriculture, which contributed about 45 to 50 per cent of the national output, is in the hands of very small farmers who have very little surplus and even the little is really difficult to get at. One of the main reasons why China took to collective farming, in the guise of cooperative farming, is partly to increase production—but more importantly, to mobilise the surplus and place it in the hands of the Government. Collective farming leaves something for the farmer and takes away the rest through compulsory purchase of foodgrains, raw materials, and so on. But this device of mobilising savings is not open to India, at least in the form of compulsion. A communist country is thus in a better position to mobilise savings than democratic countries.

It is sometimes suggested that taxation may help us to collect the surpluses. But beyond a certain point, taxation becomes a disincentive, inducing taxpayers to work and produce less. There is also a question of how the tax receipts are utilised by the Government. For, when the surplus available with business and higher incomes are taxed away, the private sector is deprived of funds. Unless the State invests them more usefully, there is no advantage so far as the total economy is concerned, whether the savings are invested through private channels or the public ones.

There is also the possibility of mobilising savings through taxation of public utilities, (*e.g.*, taxing electricity, railway fares and fertilisers), public enterprises and Government-sponsored corporations. There are, however, two difficulties : One is that unless the additional receipts come really out of increased efficiency, mere taxation will only mean increased cost and prices. Secondly, there may be wider repercussions of such taxation. For example, fertilisers should be made available to the farmers at a reasonable price and a heavy tax upon fertilisers may impinge upon agricultural production. Similarly in regard to electric power. In spite of these difficulties, it is essential for us to save 12 to 15 per cent of the national income if we have to lift ourselves up from poverty.

IV

It is interesting to look at what other developing countries did under such circumstances. The Russians, for instance, developed certain important sectors first. They took into their hands the agricultural sector through collectivisation and thus they got all the available agricultural surplus, and by exporting it obtained the needed foreign exchange. They also nationalised certain industrial sectors and utilised the profits.

But the Russian method cannot be followed in India, If, therefore, development is imperative and if the savings coefficient necessary for progress is about 15% while the actual savings is of the order of 8 to 10 per cent, what is the step the country should take? One solution is that the balance must come from external aid. In the Second Plan period the anticipated foreign exchange was of the order of eight hundred crores, but actually we got more,—Rs. 1,200 crores. The volume that could be got for the Third Plan depends upon what the other countries could give. Whatever the volume and the source, foreign aid is a very essential supplement to domestic savings. Even advanced countries, such as the United Kingdom, have been borrowers at one time or another. Until recently, Canada had a huge amount of American funds flowing in as bonus

or equity capital. The United States of America, until the First World War, was a heavy debtor, and became a creditor country only in the Second World War. And with the exception of Japan, which did not rely very much on foreign aid, most countries which have now become prosperous have at one time or another depended on foreign loans and assistance. India's prosperity will depend, at least in the next five years, upon the success in attracting foreign finance as upon the success of domestic savings mobilisation.

Capital is an important, but not the only, ingredient of development. Among the complementary factors are technological 'know-how', a good transport system, power supply, technical education, entrepreneurs and efficient administration. One of the most recent contributions to the theory of progress is the part played by Government. Until at least a few years ago, Western economists believed that the role of Government in economic progress was marginal, perhaps only maintaining law and order, and making laws. But today, even most individualistic countries, *e.g.*, U.S.A., think otherwise, because a very large chunk of the national income is handled by the Government. In U.S.A., 40 to 45% of the national income is channelled through Government, which indicates the magnitude of the Government's role. In India, this role will have to be quite considerable, and much of the controversy about the public and the private sectors appears really unnecessary. For, every case of expansion of the public sector can be defended on purely economic grounds—whether it is Sindri, or Hindustan Aircraft, or Machine Tools or Heavy Electricals. In the absence of the Government initiative no private enterprise would have taken them up. Instead of encroaching upon private sector, the public sector has actually helped it to expand. For instance, one steel plant means a large number of engineering industries. So also in Heavy Electricals and others. If power capacity in the Third Plan is doubled from 7 million kw to 15 million kw, so many accessories would be required, *e.g.*, the transformers, generators, cables, and several other things. Thus, for every rupee of investment in the public sector,

there is a proportionate investment necessary in the private sector so that the two are really complementary. Possibly in the distant future the public sector may encroach on the private one but at present there need be no such fear.

For some time to come the real issue before the country is one of restraining consumption and increasing savings. There are, no doubt, many other important considerations, such as social services, conditioning successful development; but the major economic factor is the extent to which we are able to restrain our consumption and use the surplus for further development.

Replying to a question about institutional impediments to saving, *Dr. Lokanathan* said that, first of all, we must try to create output by using these unemployed factors of production. That is, the condition for having more savings is that we should increase the output so as to have more. But the useful utilisation of the savings requires at least two things. One is that the increased demand from the unemployed who are now put to work, however small their wages, will demand increased output of consumer goods, including food articles. The second is the necessity for a certain minimum volume of tools, which again makes an inroad into the total savings. We cannot, therefore, bring about savings before all these processes are gone through. In any case, great importance should be given for social reasons to put the under-employed to work; and this demands more planned public works spread over the entire country and on a regional basis but wide enough to employ large number of people. This requires a great deal of organisation and effort.

In reply to another question on deficit financing and labour intensive methods, *Dr. Lokanathan* urged that labour intensive methods are all right provided we can get a surplus. A great difficulty in resorting to them is that the output is not sufficient even for consumption by the people who are employed, *i.e.*, the surplus after the individual's

consumption is hardly sufficient to make any further contribution. The ultimate goal is not to employ labour intensive techniques as such, especially because they are likely to become outmoded and they are going to stand in the way of better techniques. Any undue emphasis of labour intensive for a long time would defeat the purpose of growth.

In regard to deficit financing, *Dr. Lokanathan* referred to his experience as the Chairman of the Working Committee of the Economic Commission for the Far East on which all the Asian economists were represented. They regarded deficit financing under certain conditions as essential for economic development. Shri C.D. Deshmukh was the first Finance Minister who introduced deficit financing into India. Now, there is large deficit financing going on. Nearly 23% of the Second Plan investment has been deficit-financed and any further resort to it might be a little dangerous. It is not a question of whether deficit financing is right or wrong. It is under what conditions and to what extent we can resort to deficit financing. The answer to this is twofold. Provided we can keep our price level stable and provided our foreign exchange position is not adversely affected, deficit financing is not risky. But when such financing leads to inflation, increase in prices, expansion of imports and contraction of exports, that would be a signal to stop.